No. 89-637

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

RAYMOND PROZZILLO, JESS BOROWSKI, BETTY GILL, JOHN CARSON AND MARION COUNTY, WEST VIRGINIA,
Petitioners,

v.

AMERICAN STATES INSURANCE COMPANY,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION

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QUESTION PRESENTED

Should this Court review the judgment of the Fourth Circuit Court of Appeals affirming the district court's Order of Summary Judgment (unopposed by petitioners before the district court), that the Marion County Commission unlawfully disbursed funds belonging exclusively to American States Insurance Company in order to pay an IRS levy issued upon a delinquent taxpayer which was a completely different and separate entity from American States Insurance Company?

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RESPONDENT'S BRIEF IN OPPOSITION

Respondent, American States Insurance Company, respectfully requests that this Court deny the petition for a writ of certiorari seeking review of the Fourth Circuit's decision in the case at bar. The decisions of the Fourth Circuit Court of Appeals and of the United States District Court for the Northern District of West Virginia are unreported, but appear in the Petitioners' Appendix at pages 1A and 4A, respectively.

STATEMENT OF THE CASE

On or about August 22, 1980, American States Insurance Company entered into an agreement of indemnity with Arthur S. Stover dba P & S Coal Construction Company, whereby American States would provide payment and performance surety bonds on behalf of P & S for its construction contracts. The agreement provided that P & S would assign and transfer to American States all of its rights in contracts referred to in the bond, effective upon breach of any contract referred to in any surety bond issued pursuant to the agreement. (Affidavit of Thomas E. Crafton, Paragraph 3 and Exhibit A thereto).

On July 1, 1981, P & S contracted with Marion County and the Marion County Commission for the construction of a city-county complex in Fairmont, West Virginia. American States provided payment and performance surety bonds on behalf of P & S for the performance of work and material under the terms of this agreement. (Crafton Affidavit, Paragraph 4 and Exhibit B thereto). P & S defaulted on its construction contract with Marion County on December 1, 1981, and requested that American States complete the performance of the contract. At that time, American States became subrogated to all of the rights and obligations of P & S, and took immediate assignment of all contract balances, retainages and payments in progress. (Crafton Affidavit, Paragraphs 5-8).

On December 15, 1981, both P & S and American States notified the County Commission that all contract balances, retainages and payments in progress had been assigned over to American States and were to be withheld until American States, as surety, fulfilled its bond obligations and made claims for these amounts. (Crafton Affidavit, Paragraph 7 and Exhibits C and D thereto). At that

time, the County Commission was holding approximately $60,000 under the county contract which P & S had assigned to American States. Pursuant to the terms of its surety bond, American States paid in excess of $140,000, and substantially completed the contractual obligations as of November 4, 1982. (Crafton Affidavit, Paragraph 9).

On July 9, 1982, the Internal Revenue Service issued a notice of levy on wages, salary and other income belonging to delinquent taxpayer, Arthur H. Stover, dba P & S Coal Company, which the County Commission had in its possession. (Deposition of Charles Anderson, Exhibit D-1). American States also received a notice of this levy, and promptly informed the IRS that American States Insurance Company was the exclusive owner of the funds being retained by the county on this contract. (Crafton Affidavit, Paragraph 10 and Exhibit E).

Upon receiving the levy, County Administrator John Carson telephoned the IRS, and learned that American States had requested a hold on any payment from the Marion County contract. (Deposition of John Carson, p. 6). Carson had also been notified earlier by American States of its interest in the funds being held by the county. (*Id.*). The County Commission consulted Prosecuting Attorney Charles E. Anderson as to whether the county should pay the IRS levy. (Deposition of J. Carson, p. 6). Mr. Anderson opined that the County Commission should pay the levy out of the funds being retained on this contract. (Deposition of C. Anderson, pp. 5, 10, 11 and Exhibit D-3). At the time he stated his opinion, however, Anderson was unaware that P & S had assigned all contract

balances to American States pursuant to the surety agreement, and he did not consider the impact of the assignment of the contract balances in rendering his opinion. (Deposition of C. Anderson, p. 14).

The County Commission notified American States Insurance Company on September 8, 1982 that the contract balances and retainages were being held pending completion of the project. (Deposition of C. Anderson, Exhibit D-6). American States was not given any advance notice that the County intended to pay the IRS levy, and deduct the amount of the payment from the contract balances and retainages. Nonetheless, on or about September 17, 1982, Marion County issued a check for $17,546.36 to the Internal Revenue Service in payment of the IRS levy upon P & S Coal Company's property. (Deposition of C. Anderson, Exhibits D-7 and D-16).

About one month after the check had been issued, American States was first notified that the county intended to disburse certain amounts from the contract balances. (Deposition of C. Anderson, Exhibit D-10). In this letter, the county gave American States ten days to contest any of the proposed payments, but said nothing about the funds which had already been disbursed to the IRS out of American States' account. After receiving the letter, American States promptly sent a telegram to Marion County objecting to any and all payments being made out of the contract balances. (Deposition of C. Anderson, Exhibit D-11).

On November 5, 1982, after learning that American States had become subrogated to all funds held by the Marion County Commission, Prosecuting Attorney Anderson issued a second opinion letter in which he changed his advice so as to notify the county that "no payment can be

made from this account without the approval of American States Insurance Company." (Deposition of C. Anderson, Exhibit D-12). Despite this advice, the county failed to credit the contract balance account with the amount that it had paid to the IRS.

On April 18, 1983, American States demanded repayment of the contract balances and retainages which it then believed to be in the amount of $35,689.66 plus interest. (Crafton Affidavit, Paragraph 19).

Despite the County Commission's admission that American States became entitled to the contract balance on December 21, 1984, the Commission still refused to release the funds. American States filed a diversity action in the United States District Court for the Northern District of West Virginia on January 30, 1985, seeking the return of funds already disbursed and the release of funds still retained by the County.

On November 17, 1987, American States moved for Summary Judgment, and properly served each of the petitioners (defendants below) with a copy of the Motion. American States served the Motion a second time upon defense counsel, in response to complaints about poor xerographic quality of the first copy.

Petitioners failed to respond to the Motion in a timely manner. They filed no Memorandum in Opposition, they raised no defenses, they presented no evidence, and they did not ask an extension of time in which to do so. More than five months after American States moved for summary judgment, the District Court still had not received any response from the petitioners, and it issued its Order granting American States' Motion for Summary Judgment. (*See,* Memorandum Opinion of the U.S. District Court for

the Northern District of West Virginia, Petitioners' Appendix at page 4A).

Within ten days of the date on which the District Court granted summary judgment, petitioners' counsel filed its responses: a Motion to Amend the Judgment, or in the Alternative for Relief for Judgment, and also a Memorandum in Opposition to the Motion for Summary Judgment. The Court denied each of these Motions, finding no basis for allowing petitioners to present evidence at that point in the litigation.

The petitioners then appealed the District Court's decision to the United States Court of Appeals for the Fourth Circuit, but did not assert error in the District Court's summary judgment procedure or in that Court's overruling of petitioners' Motion for Relief from Judgment as a basis for its appeal. Instead, their brief raised new arguments and defenses which were never presented to the District Court regarding the propriety of the disbursements by the County Commission, the accrual date of pre-judgment interest, and the validity of American States Insurance Company's claim based upon 42 U.S.C. Section 1983. The Fourth Circuit affirmed the District Court's ruling:

> "There is no merit in the county's appeal. Summary judgment for the plaintiff was properly entered. The county knew of the assignment by the construction company to the insurance company and had no right to treat the retained funds as property of the construction company subject to its command and to the levy of the United States . . . In doing so, it completely ignored the assignment . . . of all the construction company's interest in the funds withheld by Marion

County." (Opinion of the Fourth Circuit Court of Appeals, Petitioners' Appendix, at page 3A).

The petitioners have now petitioned this Court for a writ of certiorari, once again raising arguments never presented to the District Court. Petitioners argue that the Fourth Circuit's decision conflicts with a decision of another Court of Appeals and with decisions of this Court, and that review is warranted because of problems concerning the application of the Federal Tax Lien Act. For the reasons set forth below, the petition for a writ of certiorari should be denied.

REASONS WHY THE PETITION SHOULD BE DENIED

I. Petitioners Did Not Properly Raise Or Preserve Any Of Their Factual Or Legal Arguments In Support Of The Petition, Hence This Court Lacks Jurisdiction To Review Petitioners' Arguments.

At the time the District Court issued its Order for Summary Judgment, the Court had before it no evidence or arguments on behalf of the petitioners, for the simple reason that petitioners presented no evidence and raised no defenses in the District Court. It is a basic principle of federal civil procedure that an appellate court reviews only issues and evidence heard by the trial court. *United States v. One 1971 Mercedes Benz Two-Door Coupe, etc.*, 542 F.2d 912 (4th Cir. 1976). By failing to raise defenses or present evidence in opposition to the respondent's Motion for Summary Judgment in the District Court, the petitioners have waived any such arguments or defenses. Jurisdiction does not now lie with this Court to review arguments of fact or law which were never presented to the court of record.

Petitioners' only excuse for their failure to present defenses and introduce evidence to the trial court is a lack of diligence. In the case at bar, the petitioners were twice served with American States' Motion for Summary Judgment, and were well aware of its filing date. More than four months passed between the date the Motion was served upon petitioners' counsel for a second time, and the date when the Court issued its Order of Summary Judgment on April 20, 1988. During that time, petitioners made no attempt to respond or reply to the Motion, and gave no excuse for failure to respond pursuant to Federal Rule of Civil Procedure 56(f).

This Court has consistently followed a policy of refusing to review arguments and defenses that were never considered by the trial court. *United States v. Donnelly's Estate,* 397 U.S. 286, 90 S. Ct. 1033, 25 L. Ed. 2d 312 (1970). Likewise, where a petitioner's contentions have not been assigned as error in the lower courts, they are not the proper subject of this Court's review. *Sonzinsky v. United States,* 300 U.S. 506, 57 S. Ct. 554, 81 L. Ed. 772 (1937). The purpose of this rule is to allow parties the opportunity to offer all relevant evidence at the trial level and to avoid surprise on appeal by issues on which they had no opportunity to introduce evidence. *Singleton v. Wulff,* 428 U.S. 106, 96 S. Ct. 2868, 2877, 49 L. Ed. 2d 826 (1976).

Because the petitioners failed to introduce any testimony or evidence whatsoever supporting their arguments and defenses in the court of record, and moreover, because they have never assigned the District Court's summary judgment procedure as error, all of the petitioners' defenses and arguments have been waived. They are not the proper subject of review by the Supreme Court of the United States.

II. The Decision Of The United States Court Of Appeals For The Fourth Circuit Does Not Conflict In Principle With This Court's Decisions Cited In The Petition.

The petitioners have advanced several decisions of this Court in support of their argument that a person holding funds belonging to a delinquent taxpayer must release those funds in response to an Internal Revenue Service levy, even though there may be competing claims to the funds. This argument, and each of the cases cited by petitioners, completely misses the point of this litigation.

Throughout their petition, the petitioners have portrayed American States' ownership of the retained funds merely as a "competing claim" upon funds belonging to a delinquent taxpayer. The defect in the petitioners' "competing claim" analysis was framed in clear terms by the Fourth Circuit:

> "It [petitioners] treated the claim of the insurance company as no more than a competing claim upon the fund. In doing so, [the petitioners] completely ignored the assignment of the construction company to the insurance company of all the construction company's interest in the funds withheld by Marion County." (Opinion of the Fourth Circuit Court of Appeals, Petitioners' Appendix, at page 3A).

Immediately upon default by P & S, American States became the sole owner of the retained funds, and P & S no longer had any interest whatsoever in those funds. Petitioners are now foreclosed from relitigating this fact—which is fatal to their petition.

Petitioners have cited *United States v. National Bank of Commerce,* 472 U.S. 713, 105 S. Ct. 2919, 86 L. Ed. 2d 565 (1985) as an opinion of this Court which "give[s] support to the concept of discharge from liability of persons honoring a levy." (petition for writ of certiorari, page 5-6). That opinion has no relevance or applicability to the petitioners' argument in the case at bar. Marion County was not "honoring a levy" when it surrendered American States' property in response to a levy upon the assets of delinquent taxpayer, P & S Coal and Construction Co. Moreover, unlike the fact pattern of *United States v. National Bank of Commerce,* where there were competing claims to the property held, this case involves property which was solely and indisputably owned by American States Insurance Co., an entity bearing no affiliation to the delinquent taxpayer. There were no "competing claims" in this case.

The fatal distinction between the cases cited by petitioners and the case at bar is the undisputed fact that American States Insurance Company was the sole owner of all contract balances and retainages being held by Marion County as of December 1, 1981, when it became subrogated to those retainages upon the default of P & S Coal. Thereafter, P & S Coal had no interest in, nor any right to the contract funds being held by the Marion County Commission. Fourteen days after the default, the Marion County Commission was expressly notified in writing by both P & S Coal and American States Insurance Company that American States was the assignee of the contract rights, pursuant to the indemnity agreement between P & S Coal and American States. Therefore, when the Marion County Commission received the IRS levy on July 12, 1982, upon all wages, salary, and other income belonging

to the delinquent taxpayer, P & S Coal Company, the Marion County Commission was no longer in the possession of any property whatsoever which belonged to the delinquent taxpayer. At that point, all funds held by the Marion County Commission were instead the exclusive property of American States Insurance Company.

Finally, the case cited by the petition, *United States v. National Bank of Commerce,* 472 U.S. 713, 105 S. Ct. 2919, 86 L. Ed. 2d 565 (1985), actually advances the respondent's argument because the *National Bank of Commerce* Court expressly recognized that a party "that is neither 'in possession of' nor 'obligated with respect to' property or rights to property belonging to the delinquent taxpayer" has a complete defense to compliance with a tax levy issued upon the delinquent taxpayer's property. *United States v. National Bank of Commerce,* 36 L. Ed. 2d 565 at 575. *See, also, United States v. Sterling National Bank & Trust Co. of New York,* 494 F.2d 919, 921 (2nd Cir. 1974); *Bank of Nevada v. United States,* 251 F.2d 820 (9th Cir. 1957), *cert. denied,* 356 U.S. 938, 78 S. Ct. 780, 2 L. Ed. 2d 813 (1958). The Fourth Circuit's decision in the case at bar does not, therefore, conflict with any decision of this Court.

III. The Decision Of The Fourth Circuit Court Of Appeals Does Not Conflict With Decisions Of Other Courts Of Appeals.

Petitioners argue that the opinion of the Sixth Circuit Court of Appeals in *Commonwealth of Kentucky, United Pacific Insurance Company v. Laurel County,* 805 F.2d 628 (6th Cir. 1986), *cert. denied* 484, U.S. 817, 108 S. Ct. 72 (1987), conflicts with the decision of the Fourth Circuit Court of Appeals in the case at bar. Once again, the case

cited cannot even be compared to the case at bar, because of one crucial distinction in the facts of the two cases.

In both cases, the county held funds pending the completion of a county construction project, and in both cases, the county was served with an IRS levy for unpaid taxes of a delinquent contractor. In the case at bar, however, it is clear that the delinquent taxpayer had absolutely no property rights to the funds being held by the county. To the contrary, in the Sixth Circuit case cited by petitioners, the court expressly acknowledged that the delinquent taxpayer "indeed possessed 'property' or 'rights to property' that had been surrendered in response to the levy". *Commonwealth of Kentucky, United Pacific Insurance Company,* 805 F.2d at 634. This factual distinction justifies the difference between the holding of the Sixth Circuit in *United Pacific Insurance* and the holding of the Fourth Circuit in the case at bar. In the former case, the county surrendered property to the IRS in which the delinquent taxpayer had an interest; in the instant case, the county surrendered funds to the IRS in which the delinquent taxpayer had no interest whatsoever, but which were instead property of a non-delinquent taxpayer having no affiliation with the delinquent taxpayer.

In contrast to the factual disparities between the case at bar and the Sixth Circuit case cited by the petition, the Fifth Circuit has decided a very similar case to the one at bar in *Trinity Universal Insurance Company v. United States,* 382 F.2d 317 (5th Cir. 1967). In that case, a contractor defaulted on a government contract, and a surety completed the construction under agreement with the government. The defaulting contractor later became delinquent on its federal taxes, and the government attempted to set-off the amount of the delinquent taxes from the assets to

which the surety had become subrogated. The Fifth Circuit acknowledged the surety's superior rights to the funds, holding that the surety had the right to all retained funds and remaining progress money held by the government, free from set-off for taxes owed by the contractor. The decision of the Fourth Circuit, therefore, does not conflict with any factually-comparable decision of any other Court of Appeals.

IV. The Decision Below Does Not Present Any Problems Concerning Application Of The Federal Tax Lien Act.

The issue on which the petitioners are seeking this Court's review has been portrayed in the petition as one in which a stakeholder is asked to surrender property to the IRS, where the property has more than one claimant, and where only one of those claimants is a delinquent taxpayer. That description mischaracterizes the fact pattern involved in this case.

In the case at bar, there were no "competing claimants" to the funds being held by Marion County. American States was the sole owner and sole claimant to those funds. P & S Coal had no ownership rights in the funds retained by the county, and it in fact expressly notified the county that all contract balances, retainages and payments in progress had been assigned over to American States. (Crafton Affidavit, Paragraph 7 and Exhibits C and D thereto). American States also notified the county of the default and of its right to the retainages following the default. Therefore, there is no question that the county knew that American States Insurance Company was the exclusive owner and the only claimant to the funds which it held pending the completion of the city/county complex. When the facts

surrounding the contractor's pre-levy assignment of contract balances and retainages to the surety were finally brought to the attention of petitioners' prosecuting attorney, the county's attorney at once recognized the exclusive property and subrogation rights of the respondent, reversed his earlier uninformed opinion, and advised the county that no funds could be disbursed from the contract balances and retainages without the surety's consent.

The petition cites Section 6331(a) of the Internal Revenue Code of 1954 which stands for the proposition that "the government may collect taxes of a delinquent taxpayer 'by levy upon all property and rights to property . . . belonging to such person.' " The petition further refers to Section 6332(a) which provides that any person in possession of property subject to a levy shall, upon demand of the Secretary, surrender such property or rights . . . to the Secretary. The Marion County Commission was not following the mandate of either of the cited sections when it made the disbursements in question, however, because it was not in possession of any property belonging to the delinquent taxpayer, P & S Coal Company. Instead, the sole owner of the contract balances and retainages held by the County Commission was American States Insurance Company, a clearly non-delinquent taxpayer with no levy against its assets.

Petitioners argue that "in the absence of a rule providing for discharge of liability upon payment, the person levied upon has no certain or reasonable alternatives." This argument is without merit. There is no need for this Court to review the basic legal and logical principle that a party who is not in possession of any levied-upon property need not surrender such non-existent property, and cannot possibly be penalized for failure to surrender such property

to the IRS. *See, United States v. Montchanin Mills, Inc.*, 512 F. Supp. 1192 (D. De. 1981); *United States v. Commonwealth of Pennsylvania, Department of Highways*, 349 F. Supp. 1370 (E.D. Pa. 1972); *United States v. New England Merchants National Bank*, 465 F. Supp. 83 (D. Mass. 1979); *United States v. Trans World Bank*, 382 F. Supp. 1100 (C.D. Ca. 1974); *United States v. DeCicco*, 170 F. Supp. 394 (S.D.N.Y. 1959). This case presents no significant or novel questions or controversies as to how the Federal Tax Lien Act should be applied.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari to the United States Court of Appeals for the Fourth Circuit should be denied.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on November 10, 1989, three copies of the Respondent's Brief in Opposition were mailed postage prepaid, to John C. Higinbotham, Assistant Prosecuting Attorney of Marion County, Marion County, Courthouse, Fairmont, West Virginia 26554, Counsel for petitioners.

I further certify that all parties required to be served have been served.

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